

DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506-AA82

Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act

Regulations-Imposition of Special Measure against VEF Banka

AGENCY: Financial Crimes Enforcement Network (FinCEN), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: FinCEN is issuing this notice of proposed rulemaking to impose a special measure against joint stock company VEF Banka (VEF) as a financial institution of primary money laundering concern, pursuant to the authority contained in 31 U.S.C. 5318A.

DATES: Written comments on the notice of proposed rulemaking must be submitted on or before [INSERT DATE 30 DAYS AFTER THE DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by RIN 1506-AA82, by any of the following methods:

- Federal e-rulemaking portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail: regcomments@fincen.treas.gov. Include RIN 1506-AA82 in the subject line of the message.

- Mail: FinCEN, P.O. Box 39, Vienna, VA 22183. Include RIN 1506-AA82 in the body of the text.

Instructions: It is preferable for comments to be submitted by electronic mail because paper mail in the Washington, D.C., area may be delayed. Please submit comments by one method only. All submissions received must include the agency name and the Regulatory Information Number (RIN) for this rulemaking. All comments received will be posted without change to <http://www.fincen.gov>, including any personal information provided. Comments may be inspected at FinCEN between 10 a.m. and 4 p.m. in the FinCEN reading room in Washington, D.C. Persons wishing to inspect the comments submitted must request an appointment by telephone at (202) 354-6400 (not a toll-free number).

FOR FURTHER INFORMATION CONTACT: Regulatory Policy and Programs Division, FinCEN, (800) 949-2732.

SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory Provisions

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA PATRIOT Act), Public Law 107-56. Title III of the USA PATRIOT Act amends the anti-money laundering provisions of the Bank Secrecy Act (BSA), codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5314, 5316-5332, to promote the prevention, detection, and prosecution of international money laundering and the financing of terrorism. Regulations implementing the BSA appear at

31 CFR Part 103. The authority of the Secretary of the Treasury (“the Secretary”) to administer the BSA and its implementing regulations has been delegated to the Director of FinCEN.¹

Section 311 of the USA PATRIOT Act (“section 311”) added section 5318A to the BSA, granting the Secretary the authority, upon finding that reasonable grounds exist for concluding that a foreign jurisdiction, institution, class of transactions, or type of account is of “primary money laundering concern,” to require domestic financial institutions and financial agencies to take certain “special measures” against the primary money laundering concern. Section 311 identifies factors for the Secretary to consider and federal agencies to consult before the Secretary may conclude that a jurisdiction, institution, class of transactions, or type of account is of primary money laundering concern. The statute also provides similar procedures, including factors and consultation requirements, for selecting the specific special measures to be imposed against the primary money laundering concern.

Taken as a whole, section 311 provides the Secretary with a range of options that can be adapted to target specific money laundering concerns most effectively. These options give the Secretary the authority to bring additional pressure on those jurisdictions and institutions that pose money laundering threats. Through the imposition of various special measures, the Secretary can gain more information about the concerned jurisdictions, institutions, transactions, and accounts; can more effectively monitor the respective jurisdictions, institutions, transactions, and accounts; and/or can protect U.S.

¹ Therefore, references to the authority of the Secretary of the Treasury under section 311 of the USA PATRIOT Act apply equally to the Director of FinCEN.

financial institutions from involvement with jurisdictions, institutions, transactions, or accounts that pose a money laundering concern.

Before making a finding that reasonable grounds exist for concluding that a foreign financial institution is of primary money laundering concern, the Secretary is required by the Bank Secrecy Act to consult with both the Secretary of State and the Attorney General. The Secretary also is required by section 311 to consider “such information as the Secretary determines to be relevant, including the following potentially relevant factors:”

- The extent to which such financial institution is used to facilitate or promote money laundering in or through the jurisdiction;
- The extent to which such financial institution is used for legitimate business purposes in the jurisdiction; and
- The extent to which the finding that the institution is of primary money laundering concern is sufficient to ensure, with respect to transactions involving the institution operating in the jurisdiction, that the purposes of the BSA continue to be fulfilled, and to guard against international money laundering and other financial crimes.

If the Secretary determines that a foreign financial institution is of primary money laundering concern, the Secretary must determine the appropriate special measure(s) to address the specific money laundering risks. Section 311 provides a range of special measures that can be imposed individually, jointly, in any combination, and in any sequence.² The Secretary’s imposition of special measures requires additional

² Available special measures include requiring: (1) recordkeeping and reporting of certain financial transactions; (2) collection of information relating to beneficial ownership; (3) collection of information

consultations to be made and factors to be considered. The statute requires the Secretary to consult with appropriate federal agencies and other interested parties³ and to consider the following specific factors:

- Whether similar action has been or is being taken by other nations or multilateral groups;
- Whether the imposition of any particular special measure would create a significant competitive disadvantage, including any undue cost or burden associated with compliance, for financial institutions organized or licensed in the United States;
- The extent to which the action or the timing of the action would have a significant adverse systemic impact on the international payment, clearance, and settlement system, or on legitimate business activities involving the particular institution; and
- The effect of the action on United States national security and foreign policy.⁴

B. VEF

relating to certain payable-through accounts; (4) collection of information relating to certain correspondent accounts; and (5) prohibition or conditions on the opening or maintaining of correspondent or payable-through accounts. 31 U.S.C. 5318A (b)(1)-(5). For a complete discussion of the range of possible countermeasures, see the notice at 68 FR 18917 (April 17, 2003), which proposed the imposition of special measures against Nauru.

³ Section 5318A(a)(4)(A) requires the Secretary to consult with the Chairman of the Board of Governors of the Federal Reserve System, any other appropriate Federal banking agency, the Secretary of State, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the National Credit Union Administration, and, in the sole discretion of the Secretary, “such other agencies and interested parties as the Secretary may find to be appropriate.” The consultation process must also include the Attorney General if the Secretary is considering prohibiting or imposing conditions on domestic financial institutions maintaining correspondent account relationships with the designated entity.

⁴ Classified information used in support of a section 311 finding and measure(s) may be submitted by the Treasury to a reviewing court ex parte and in camera. See section 376 of the Intelligence Authorization Act for Fiscal Year 2004, Pub. L. 108-177 (amending 31 U.S.C. 5318A by adding new paragraph (f)).

In this rulemaking, FinCEN proposes the imposition of the fifth special measure (31 U.S.C. 5318A(b)(5)) against VEF, a commercial bank in Latvia. The fifth special measure prohibits or conditions the opening or maintaining of correspondent or payable-through accounts for the designated institution by U.S. financial institutions. This special measure may be imposed only through the issuance of a regulation.

VEF is headquartered in Riga, the capital of the Republic of Latvia. VEF is one of the smallest of Latvia's 23 banks, reported to have approximately \$80 million in assets and 87 employees. It has one subsidiary, Veiksmes lizings, which offers financial leasing and factoring services. In addition to its headquarters in Riga, VEF has one branch in Riga, and one representative office in the Czech Republic. VEF offers corporate and private banking services, issues a variety of credit cards for non-Latvians, and provides currency exchange through Internet banking services, i.e. virtual currencies. In addition, according to VEF's financial statements, it maintains 34 correspondent accounts with countries worldwide, including at least one account in the United States.

VEF offers confidential banking services for non-Latvian customers. In fact, VEF's web site advertises, "*VEF Banka guarantees keeping in secret customer information (information about customer's operations, account balance and other bank operations). It guarantees not revealing this information to third person except the cases, when the customer has agreed that the information can be revealed or when it is demanded by the legislation of the Republic of Latvia.*" Another section of VEF's web site lists documents (from countries frequently associated with money laundering activities) that are required to open a VEF corporate bank account. According to the bank's financial statements, a large portion of the bank's deposits comes from private

companies. Less than 20 percent of these deposits are from individuals or companies located in Latvia. A large number of foreign depositors or a large percentage of assets in foreign funds are both indicators that a bank may be used to launder money.

Additionally, approximately 75 percent of the bank's fee income and commissions are generated from payment cards and money transfers, both incoming and outgoing, from correspondent banks.

The bank's dealings with foreign shell companies, provision of confidential banking services, and lack of controls and procedures adequate to the risks involved, make VEF vulnerable to money laundering and other financial crimes. As a result of the significant number of credit and debit transactions involving entities that appear to be shell corporations banking at VEF, some U.S. financial institutions have already closed correspondent relationships with VEF.

C. Latvia

Latvia's role as a regional financial center, the number of commercial banks with respect to its size, and those banks' sizeable non-resident deposit base continue to pose significant money laundering risks. Latvian authorities recently have sought tighter legislative controls, regulations, and "best practices" designed to fight financial crime. Despite Latvia's recent efforts and amended laws, however, money laundering in Latvia remains a concern. Latvia's geographical position, situated by the Baltic Sea and bordering Russia, Estonia, Belarus, and Lithuania, make it an attractive transit country for both legitimate and illegitimate trade. Sources of laundered money in these countries include counterfeiting, corruption, arms trafficking, contraband smuggling, and other crimes. It is believed that most of Latvia's narcotics trafficking is conducted by

organized crime groups that began with cigarette and alcohol smuggling and then progressed to narcotics.

Of particular concern is that many of Latvia's institutions do not appear to serve the Latvian community, but instead serve suspect foreign private shell companies. A common way for criminals to disguise illegal proceeds is to establish shell companies in countries known for lax enforcement of anti-money laundering laws. The criminals use the shell companies to conceal the true ownership of the accounts and assets, which is ideal for the laundering of funds. Similarly, as mentioned above, a disproportionate amount of foreign depositors or assets may indicate that a bank is being used to launder money or evade taxes. Latvia's 23 banks held approximately \$5 billion in nonresident deposits at the end of 2004, mainly from Russia and other parts of the former Soviet Union. These deposits accounted for more than half of all the money held in Latvian banks.

Despite growing efforts by the Latvian government for reform, material weaknesses in the implementation and enforcement of its anti-money laundering laws exist. To date there have been no forfeitures of illicit proceeds based on money laundering. In addition, suspicious activity reporting thresholds remain high, at nearly 40,000 LATS (about \$80,000 dollars) for most transactions, which fails to capture significant activity below this threshold. Furthermore, since 2004, only two money laundering cases have been tried in Latvian courts, with both cases ending in acquittals.

Latvia has a general reputation for permissive bank secrecy laws and lax enforcement, as evidenced by multiple non-Latvian web sites that offer to establish offshore accounts with Latvian banks in general, and VEF, in particular. The sites claim

that Latvian banks offer secure and confidential banking, especially through online banking services. FinCEN also has reason to believe that certain Latvian financial institutions are used by online criminal groups, frequently referred to as “carding” groups, to launder the proceeds of their illegal activities. Such groups consist of computer hackers and other criminals that use the Internet as a means of perpetrating credit card fraud, identity theft, and related financial crimes. One of the primary concerns of carding group members is their ability to convert the funds obtained through fraud into cash. Anonymity is another major consideration for online criminals. Reports substantiate that in order to support these two needs, a significant number of carders have turned to Latvian financial institutions for the safe and quasi-anonymous cashing out of their illegal proceeds. FinCEN has additional reason to believe that certain Latvian financial institutions allow non-citizens to open accounts over the Internet, and offer anonymous ATM cards with high or no withdrawal limits.

Latvia has taken steps to address money laundering risks and corruption. In February 2004, a new anti-money laundering law removed some barriers that impeded the prosecution of money laundering. The law expanded the categories of financial institutions covered by reporting requirements to include auditors, lawyers, and high-value dealers, as well as credit institutions. The law also recognizes terrorism as a predicate offense for money laundering.

Recognizing the existence of widespread official corruption, the Latvian government, in January 2002, established the Anti-Corruption Bureau (ACB), an independent agency to combat public corruption by investigating and prosecuting Latvian officials involved in unlawful activities. In 2004, the ACB reviewed over 700 cases of

suspected public corruption. Although this initiative is encouraging, FinCEN considers the high levels of corruption in Latvia's government and security forces an impediment both to its international information-sharing efforts and to the fair enforcement of Latvia's anti-money laundering laws.

According to the International Narcotics Strategy Control Report (INSCR) published in March 2005 by the U.S. Department of State, Latvia's banking system is vulnerable to the laundering of narcotics proceeds. The report designates Latvia a jurisdiction of "primary concern." "Jurisdictions of Primary Concern" in INSCR are jurisdictions that are identified as "major money laundering countries," that is, countries "whose financial institutions engage in currency transactions involving significant amounts of proceeds from international narcotics trafficking."

II. Imposition of Special Measure Against VEF as a Financial Institution of Primary Money Laundering Concern

A. Finding

Based on a review and analysis of relevant information, consultations with relevant federal agencies and departments, and after consideration of the factors enumerated in section 311, the Secretary, through his delegate, the Director of FinCEN, has determined that reasonable grounds exist for concluding that VEF is a financial institution of primary money laundering concern based on a number of factors, including:

1. The Extent to which VEF Has Been Used to Facilitate or Promote Money Laundering in or through the Jurisdiction

FinCEN has determined, based upon a variety of sources, that VEF is being used to facilitate or promote money laundering and other financial crimes. Proceeds of illicit

activity have been transferred by shell companies with no apparent legitimate business purpose to or through correspondent accounts held by VEF at U.S. financial institutions. As already stated, criminals frequently use shell companies to launder the proceeds of their crimes. A significant number of companies, organized in various countries including the United States, have used accounts at VEF to move millions of U.S. dollars around the world. In a four-month period, VEF initiated or accepted on behalf of a single shell corporation over 300 wire transfers totaling more than \$26 million, involving such countries as the United Arab Emirates, Kuwait, Russia, India, and China. In addition, for a two-year period, VEF transferred over \$200 million on behalf of two highly suspect corporate accountholders, which is a substantial amount of wire activity for VEF's size.

Many of the private shell companies holding accounts at VEF lack proper documentation of ownership, annual reports, and the reason for the business transactions, while other companies had no listed telephone numbers. Due to concerns about transactions by such companies through accounts at VEF, some U.S. financial institutions have already terminated their correspondent relationships with VEF.

Several accountholders at VEF have repeatedly engaged in a pattern of activity indicative of money laundering. In fact, several VEF accountholders are linked to an international Internet crime organization that has been indicted in federal court for electronic theft of personal identifying information, credit card and debit card fraud, and the production and sale of false identification documents. The defendants and their co-conspirators commonly sent and received payment for illicit merchandise and services via money transfers or digital currency services such as "E-Gold" or "Web Money" transfers. As discussed below, Web Money purportedly holds an account at VEF.

One reason that Internet financial crime groups are interested in opening accounts at VEF is that the “Visa Electron” card associated with a VEF account has no limit on the amount of money that can be withdrawn from an ATM. The ability to make limitless ATM withdrawals is an essential component to the execution of large financial fraud schemes typically associated with carding networks. In addition, the U.S. government has reason to believe that individuals who wish to obtain a Web Money Card will be issued a card linked to a sub-account from Web Money Card’s main account at VEF. Criminals who have applied for, obtained, and used Web Money Cards claim that VEF requires a notarized copy of a photo identification document to open an account. The legitimacy of these documents and the notary stamp, however, are reportedly never verified by VEF. Given the level of sophistication of many of these criminals, obtaining high-quality fraudulent identification documents, including a fraudulent notary’s stamp, is not a difficult task. Through Web Money’s accounts at VEF, these online criminal groups have used VEF to launder their illicit proceeds.

2. The Extent to which VEF Is Used for Legitimate Business Purposes in the Jurisdiction

It is difficult to determine the extent to which VEF is used for legitimate purposes. As already stated, inordinately high percentages of foreign assets or depositors and the use of a bank by shell companies are both indicators of possible money laundering activities. A significant portion of VEF’s business is with shell companies. As already stated, the bank has a reputation for servicing foreign shell companies as evidenced by the many websites advertising bank account opening services for such entities. VEF is an important banking resource for such companies who use VEF to access the international financial system to pursue illicit financial activities. FinCEN

believes that any legitimate use of VEF is significantly outweighed by its use to promote or facilitate money laundering and other financial crimes. Nevertheless, FinCEN specifically solicits comments on the impact of the proposed special measure upon any legitimate transactions conducted with VEF involving, in particular, U.S. persons or entities, foreign persons, entities, and governments, and multilateral organizations doing legitimate business with persons, entities, or the government of the jurisdiction or operating in the jurisdiction.

3. The Extent to which Such Action Is Sufficient to Ensure, with Respect to Transactions Involving VEF, that the Purposes of the BSA Continue to Be Fulfilled, and to Guard against International Money Laundering and Other Financial Crimes

As detailed above, FinCEN has reasonable grounds to conclude that VEF is being used to promote or facilitate international money laundering. Currently, there are no protective measures that specifically target VEF. Thus, finding VEF to be a financial institution of primary money laundering concern and prohibiting the maintenance of correspondent accounts for that institution are necessary steps to prevent suspect accountholders at VEF from accessing the U.S. financial system to facilitate money laundering or to engage in any other criminal purpose. The proposed special measure would not only prohibit U.S. financial institutions from maintaining direct correspondent relationships with VEF, but also would require them to take reasonable steps to prevent indirect use of correspondent services by VEF through intermediary financial institutions. The finding of primary money laundering concern and the imposition of the special measure also will bring criminal conduct occurring at or through VEF to the attention of the international financial community and, it is hoped, further limit the bank's ability to be used for money laundering or for other criminal purposes.

B. Imposition of Special Measure

As a result of the finding that VEF is a financial institution of primary money laundering concern, and based upon the additional consultations and the consideration of relevant factors, the Secretary, through his delegate, the Director of FinCEN, has determined that reasonable grounds exist for the imposition of the special measure authorized by 31 U.S.C. 5318A(b)(5).⁵ That special measure authorizes the prohibition of opening or maintaining correspondent accounts⁶ by any domestic financial institution or agency for or on behalf of a targeted financial institution. A discussion of the additional section 311 factors relevant to imposing this particular special measure follows.

1. Whether Similar Actions Have Been or Will Be Taken by Other Nations or Multilateral Groups against VEF.

Other countries and multilateral groups have not, as yet, taken action similar to that proposed in this rulemaking to prohibit domestic financial institutions and agencies from opening or maintaining a correspondent account for or on behalf of VEF, and to require those domestic financial institutions and agencies to screen their correspondents for nested correspondent accounts held by VEF. FinCEN encourages other countries to take similar action based on the findings contained in this rulemaking. In the absence of similar action by other countries, it is even more imperative that the fifth special measure be imposed in order to prevent access by VEF to the U.S. financial system.

2. Whether the Imposition of the Fifth Special Measure Would Create a

⁵ In connection with this section, FinCEN consulted with staff of the Federal functional regulators, the Department of Justice, and the State Department.

⁶ For purposes of the proposed rule, a correspondent account is defined as an account established to receive deposits from, or make payments or other disbursements on behalf of, a foreign bank, or handle other financial transactions related to the foreign bank.

Significant Competitive Disadvantage, Including Any Undue Cost or Burden Associated With Compliance, for Financial Institutions Organized or Licensed in the United States

The fifth special measure sought to be imposed by this rulemaking would prohibit covered financial institutions from opening and maintaining correspondent accounts for, or on behalf of, VEF. As a corollary to this measure, covered financial institutions also would be required to take reasonable steps to apply special due diligence, as set forth below, to all of their correspondent accounts to help ensure that no such account is being used indirectly to provide services to VEF. FinCEN does not expect the burden associated with these requirements to be significant, given its understanding that few U.S. banks currently maintain correspondent accounts for VEF. There is a minimal burden involved in transmitting a one-time notice to all correspondent accountholders concerning the prohibition on indirectly providing services to VEF. In addition, all U.S. financial institutions currently apply some degree of due diligence to the transactions or accounts subject to sanctions administered by the Office of Foreign Assets Control (OFAC) of the Department of the Treasury. As explained in more detail in the section-by-section analysis below, financial institutions should be able to easily adapt their current screening procedures for OFAC sanctions to comply with this special measure. Thus, the special due diligence that would be required by this rulemaking is not expected to impose a significant additional burden upon U.S. financial institutions.

3. The Extent to which the Proposed Action or Timing of the Action Will Have a Significant Adverse Systemic Impact on the International Payment, Clearance, and Settlement System, or on Legitimate Business Activities of VEF

This proposed rulemaking targets VEF specifically; it does not target a class of financial transactions (such as wire transfers) or a particular jurisdiction. VEF is not a

major participant in the international payment system and is not relied upon by the international banking community for clearance or settlement services. Thus, the imposition of the fifth special measure against VEF will not have a significant adverse systemic impact on the international payment, clearance, and settlement system. In light of the reasons for imposing this special measure, FinCEN does not believe that it will impose an undue burden on legitimate business activities, and notes that the presence of approximately 15 larger banks in Latvia will alleviate the burden on legitimate business activities within that jurisdiction.

4. The Effect of the Proposed Action on U.S. National Security and Foreign Policy

The exclusion from the U.S. financial system of banks that serve as conduits for significant money laundering activity and other financial crimes enhances national security by making it more difficult for money launderers and other criminals to access the substantial resources of the U.S. financial system. In addition, the imposition of the fifth special measure against VEF would complement the U.S. Government's overall foreign policy strategy of making entry into the U.S. financial system more difficult for high-risk financial institutions located in jurisdictions that have lax anti-money laundering controls. More generally, the imposition of the fifth special measure would complement diplomatic actions undertaken by both the Latvian and U.S. Governments to expose and disrupt international money laundering and other financial crimes.

Therefore, after conducting the required consultations and weighing the relevant factors, FinCEN has determined that reasonable grounds exist for concluding that VEF is a financial institution of primary money laundering concern and for imposing the special measure authorized by 31 U.S.C. 5318A(b)(5).

III. Section-by-Section Analysis

The proposed rule would prohibit covered financial institutions from establishing, maintaining, administering, or managing in the United States any correspondent account for, or on behalf of, VEF. As a corollary to this prohibition, covered financial institutions would be required to apply special due diligence to their correspondent accounts to guard against their indirect use by VEF. At a minimum, that special due diligence must include two elements. First, a covered financial institution must notify its correspondent accountholders that they may not provide VEF with access to the correspondent account maintained at the covered financial institution. Second, a covered financial institution must take reasonable steps to identify any indirect use of its correspondent accounts by VEF, to the extent that such indirect use can be determined from transactional records maintained by the covered financial institution in the normal course of business. A covered financial institution must take a risk-based approach when deciding what, if any, other due diligence measures it should adopt to guard against the indirect use of its correspondent accounts by VEF, based on risk factors such as the type of services it offers and geographic locations of its correspondents.

A. 103.192(a) – Definitions

1. Correspondent account

Section 103.192.(a)(1) defines the term “correspondent account” by reference to the definition contained in 31 CFR 103.175(d)(1)(ii). Section 103.175(d)(1)(ii) defines a correspondent account to mean an account established to receive deposits from, or make payments or other disbursements on behalf of, a foreign bank, or to handle other financial transactions related to the foreign bank.

In the case of a U.S. depository institution, this broad definition would include most types of banking relationships between a U.S. depository institution and a foreign bank, including payable-through accounts.

In the case of securities broker-dealers, futures commission merchants, introducing brokers, and investment companies that are open-end companies (mutual funds), a correspondent account would include any account that permits the foreign bank to engage in (1) trading in securities and commodity futures or options, (2) funds transfers, or (3) other types of financial transactions.

FinCEN is using the same definition for purposes of the proposed rule as that established in the final rule implementing sections 313 and 319(b) of the USA PATRIOT Act,⁷ except that the term is being expanded to cover such accounts maintained by mutual funds, futures commission merchants, and introducing brokers.

2. Covered financial institution

Section 103.192(a)(2) of the proposed rule defines covered financial institution to mean all of the following: any insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h))); a commercial bank or trust company; a private banker; an agency or branch of a foreign bank in the United States; a credit union; a thrift institution; a corporation acting under section 25A of the Federal Reserve Act (12 U.S.C. 611 et seq.); a broker or dealer registered or required to register with the SEC under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.); a futures commission merchant or an introducing broker registered, or required to register, with the CFTC under the Commodity Exchange Act (7 U.S.C. 1 et seq.); and an investment company (as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3)) that is an

⁷ See 67 FR 60562 (Sept. 26, 2002), codified at 31 CFR 103.175(d)(1).

open-end company (as defined in section 5 of the Investment Company Act of 1940 (15 U.S.C. 80a-5)) that is registered, or required to register, with the SEC under Section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

3. VEF

Section 103.192(a)(3) of the proposed rule defines VEF to include all branches, offices, and subsidiaries of VEF operating in Latvia or in any other jurisdiction.

Veiksmes līzings, and any of its branches, is included in the definition. FinCEN will provide information regarding the existence or establishment of any other subsidiaries as it becomes available. Nevertheless, covered financial institutions should take commercially reasonable measures to determine whether a customer is a subsidiary of VEF.

B. 103.192(b) – Requirements for covered Financial Institutions

For purposes of complying with the proposed rule's prohibition on the opening or maintaining of correspondent accounts for, or on behalf of, VEF, FinCEN expects that a covered financial institution will take such steps that a reasonable and prudent financial institution would take to protect itself from loan fraud or other fraud or loss based on misidentification of a person's status.

1. Prohibition on Direct Use of Correspondent Accounts

Section 103.192(b)(1) of the proposed rule prohibits all covered financial institutions from establishing, maintaining, administering, or managing a correspondent account in the United States for, or on behalf of, VEF. The prohibition would require all covered financial institutions to review their account records to ensure that they maintain no accounts directly for, or on behalf of, VEF.

2. Special Due Diligence of Correspondent Accounts to Prohibit Indirect Use

As a corollary to the prohibition on maintaining correspondent accounts directly for VEF, section 103.192(b)(2) requires a covered financial institution to apply special due diligence to its correspondent accounts that is reasonably designed to guard against their indirect use by VEF. At a minimum, that special due diligence must include notifying correspondent accountholders that they may not provide VEF with access to the correspondent account maintained at the covered financial institution. For example, a covered financial institution may satisfy this requirement by transmitting the following notice to all of its correspondent accountholders:

Notice: Pursuant to U.S. regulations issued under section 311 of the USA PATRIOT Act, 31 CFR 103.192, we are prohibited from establishing, maintaining, administering or managing a correspondent account for, or on behalf of, joint stock company VEF Banka (VEF) or any of its subsidiaries, including Veiksmes lizings. The regulations also require us to notify you that you may not provide VEF or any of its subsidiaries with access to the correspondent account you hold at our financial institution. If we become aware that VEF or any of its subsidiaries is indirectly using the correspondent account you hold at our financial institution, we will be required to take appropriate steps to block such access, including terminating your account.

The purpose of the notice requirement is to help ensure cooperation from correspondent accountholders in denying VEF access to the U.S. financial system, as well as to increase awareness within the international financial community of the risks and deficiencies of VEF. However, FinCEN does not require or expect a covered financial institution to obtain a certification from its correspondent accountholders that indirect access will not be provided in order to comply with this notice requirement. Instead, methods of compliance with the notice requirement could include, for example, transmitting a one-time notice by mail, fax, or e-mail to a covered financial institution's correspondent account customers informing them that they may not provide VEF with

access to the covered financial institution's correspondent account, or including such information in the next regularly occurring transmittal from the covered financial institution to its correspondent accountholders. FinCEN specifically solicits comments on the appropriate form, scope, and timing of the notice that would be required under the rule.

A covered financial institution also would be required under this rulemaking to take reasonable steps to identify any indirect use of its correspondent accounts by VEF, to the extent that such indirect use can be determined from transactional records maintained by the covered financial institution in the normal course of business. For example, a covered financial institution would be expected to apply an appropriate screening mechanism to be able to identify a funds transfer order that on its face listed VEF as the originator's or beneficiary's financial institution, or otherwise referenced VEF. An appropriate screening mechanism could be the mechanism used by a covered financial institution to comply with sanctions programs administered by OFAC. FinCEN specifically solicits comments on the requirement under the proposed rule that a covered financial institution take reasonable steps to screen its correspondent accounts in order to identify any indirect use of such accounts by VEF.

Notifying its correspondent accountholders and taking reasonable steps to identify any indirect use of its correspondent accounts by VEF in the manner discussed above are the minimum due diligence requirements under the proposed rule. Beyond these minimum steps, a covered financial institution should adopt a risk-based approach for determining what, if any, other due diligence measures it should implement to guard against the indirect use of its correspondents accounts by VEF, based on risk factors such

as the type of services it offers and the geographic locations of its correspondent accountholders.

A covered financial institution that obtains knowledge that a correspondent account is being used by a foreign bank to provide indirect access to VEF must take all appropriate steps to block such indirect access, including, where necessary, terminating the correspondent account. A covered financial institution may afford the foreign bank a reasonable opportunity to take corrective action prior to terminating the correspondent account. Should the foreign bank refuse to comply, or if the covered financial institution cannot obtain adequate assurances that the account will not be available to VEF, the covered financial institution must terminate the account within a commercially reasonable time. This means that the covered financial institution should not permit the foreign bank to establish any new positions or execute any transactions through the account, other than those necessary to close the account. A covered financial institution may reestablish an account closed under the proposed rule if it determines that the account will not be used to provide banking services indirectly to VEF. FinCEN specifically solicits comment on the requirement under the proposed rule that a covered financial institution block indirect access to VEF once such indirect access is identified.

3. Reporting Not Required

Section 103.192(b)(3) of the proposed rule clarifies that the rule does not impose any reporting requirement upon any covered financial institution that is not otherwise required by applicable law or regulation. A covered financial institution must, however, document its compliance with the requirement that it notify its correspondent

acountholders that they may not provide VEF with access to the correspondent account maintained at the covered financial institution.

IV. Request for Comments

FinCEN invites comments on all aspects of the proposal to prohibit the opening or maintaining of correspondent accounts for or on behalf of VEF, and specifically invites comments on the following matters:

1. The appropriate form, scope, and timing of the notice to correspondent acountholders that would be required under the rule;
2. The appropriate scope of the proposed requirement for a covered financial institution to take reasonable steps to identify any indirect use of its correspondent accounts by VEF;
3. The appropriate steps a covered financial institution should take once it identifies an indirect use of one of its correspondent accounts by VEF; and
4. The impact of the proposed special measure upon any legitimate transactions conducted with VEF by U.S. persons and entities, foreign persons, entities, and governments, and multilateral organizations doing legitimate business with persons, entities, or Latvia, or operating a legitimate business in Latvia.

V. Regulatory Flexibility Act

It is hereby certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. FinCEN understands that VEF maintains a correspondent account at one large bank in the United States. Thus, the prohibition on maintaining such accounts will not have a significant impact on a substantial number of small entities. In addition, all U.S. persons, including U.S.

financial institutions, should currently exercise some degree of due diligence in order to comply with U.S. sanctions programs administered by OFAC, which can easily be modified to monitor for the direct and indirect use of correspondent accounts by VEF. Thus, the special due diligence that would be required by this rulemaking – i.e., the one-time transmittal of notice to correspondent accountholders, and the screening of transactions to identify any indirect use of correspondent accounts – is not expected to impose a significant additional economic burden upon small U.S. financial institutions. FinCEN invites comments from members of the public who believe there will be a significant economic impact on small entities.

VI. Paperwork Reduction Act

The collection of information contained in this proposed rule is being submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent (preferably by fax (202-395-6974)) to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Paperwork Reduction Project (1506), Washington, DC 20503 (or by e-mail to Alexander_T._Hunt@omb.eop.gov), with a copy to FinCEN by mail or e-mail at the addresses previously specified. Comments on the collection of information should be received by [INSERT DATE THAT IS 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. In accordance with the requirements of the Paperwork Reduction Act of 1995, 44 U.S.C. 3506(c)(2)(A), and its implementing regulations, 5 CFR 1320, the following information concerning the collection of information as

required by 31 CFR 103.192 is presented to assist those persons wishing to comment on the information collection.

The collection of information in this proposed rule is in 31 CFR 103.192(b)(2)(i) and 31 CFR 103.192(b)(3)(i). The disclosure requirement in 31 CFR 103.192(b)(2)(i) is intended to ensure cooperation from correspondent accountholders in denying VEF access to the U.S. financial system, as well as to increase awareness within the international financial community of the risks and deficiencies of VEF. The information required to be maintained by 31 CFR 103.192(b)(3)(i) will be used by federal agencies and certain self-regulatory organizations to verify compliance by covered financial institutions with the provisions of 31 CFR 103.192. The class of financial institutions affected by the disclosure requirement is identical to the class of financial institutions affected by the recordkeeping requirement. The collection of information is mandatory.

Description of Affected Financial Institutions: Banks, broker-dealers in securities, futures commission merchants and introducing brokers, and mutual funds maintaining correspondent accounts.

Estimate Number of Affected Financial Institutions: 5,000.

Estimated Average Annual Burden Hours Per Affected Financial Institution: The estimated average burden associated with the collection of information in this proposed rule is one hour per affected financial institution.

Estimated Total Annual Burden: 5,000 hours.

FinCEN specifically invites comments on: (a) whether the proposed collection of information is necessary for the proper performance of the mission of FinCEN, including whether the information shall have practical utility; (b) the accuracy of FinCEN's

estimate of the burden of the proposed collection of information; (c) ways to enhance the quality, utility, and clarity of the information required to be maintained; (d) ways to minimize the burden of the required collection of information, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to maintain the information.

VII. Executive Order 12866

This proposed rule is not a significant regulatory action for purposes of Executive Order 12866, “Regulatory Planning and Review.”

List of Subjects in 31 CFR Part 103

Administrative practice and procedure, Banks and banking, Brokers, Counter-money laundering, Counter-terrorism, and Foreign banking.

Authority and Issuance

For the reasons set forth in the preamble, part 103 of title 31 of the Code of Federal Regulations is proposed to be amended as follows:

PART 103 – FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FINANCIAL TRANSACTIONS

1. The authority citation for part 103 is amended to read as follows:

Authority: 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314, 5316-5332; title III, secs. 311, 312, 313, 314, 319, 326, 352, Pub. L. 107-56, 115 Stat. 307.

2. Subpart I of part 103 is proposed to be amended by adding new § 103.192, as follows:

§ 103.192 Special measures against VEF.

(a) Definitions. For purposes of this section:

(1) Correspondent account has the same meaning as provided in § 103.175(d)(1)(ii).

(2) Covered financial institution has the same meaning as provided in § 103.175(f)(2) and also includes:

(i) A futures commission merchant or an introducing broker registered, or required to register, with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.); and

(ii) An investment company (as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3)) that is an open-end company (as defined in section 5 of the Investment Company Act (15 U.S.C. 80a-5)) and that is registered, or required to register, with the Securities and Exchange Commission under section 8 of the Investment Company Act (15 U.S.C. 80a-8).

(3) Subsidiary means a company of which more than 50 percent of the voting stock or analogous equity interest is owned by another company.

(4) VEF means any branch, office, or subsidiary of joint stock company VEF Banka operating in Latvia or any other jurisdiction.

(b) Requirements for covered financial institutions--(1) Prohibition on direct use of correspondent accounts. A covered financial institution shall terminate any correspondent account that is established, maintained, administered, or managed in the United States for, or on behalf of, VEF.

(2) Special due diligence of correspondent accounts to prohibit indirect use. (i) A covered financial institution shall apply special due diligence to its correspondent

accounts that is reasonably designed to guard against their indirect use by VEF. At a minimum, that special due diligence must include:

(A) Notifying correspondent accountholders that they may not provide VEF with access to the correspondent account maintained at the covered financial institution; and

(B) Taking reasonable steps to identify any indirect use of its correspondent accounts by VEF to the extent that such indirect use can be determined from transactional records maintained in the covered financial institution's normal course of business.

(ii) A covered financial institution shall take a risk-based approach when deciding what, if any, other due diligence measures it should adopt to guard against the indirect use of its correspondent accounts by VEF.

(iii) A covered financial institution that obtains knowledge that a correspondent account is being used by the foreign bank to provide indirect access to VEF, shall take all appropriate steps to block such indirect access, including, where necessary, terminating the correspondent account.

(3) Recordkeeping and reporting. (i) A covered financial institution is required to document its compliance with the notice requirement set forth in paragraph (b)(2)(i)(A) of this section.

(ii) Nothing in this section shall require a covered financial institution to report any information not otherwise required to be reported by law or regulation.

Dated: _____

William J. Fox
Director,
Financial Crimes Enforcement Network